## BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

### I.

### Opinion of Circuit Court.

The opinion in the Circuit Court (R. 94), dated November 11, 1941, has not been printed in the Official Fed. (2nd) Reporter.

### II.

### Grounds of Jurisdiction.

(A) Jurisdiction is invoked under 28 U. S. C. A., Section 347, and 26 U. S. C. A., Section 641.

(B) The statute involved is the Revenue Act of 1934, C. 277, 48 Stat. 680, Sec. 351. The applicable part thereof reads as follows:

> "Sec. 351. SURTAX ON PERSONAL HOLDING COMPANIES. (a) IMPOSITION OF TAX.—There shall be levied, collected, and paid, for each taxable year, upon the undistributed adjusted net income of every personal holding company a surtax equal to the sum of the following:
>
> (1) 30 per centum of the amount thereof not in excess of $100,000; plus
>
> (2) 40 per centum of the amount thereof in excess of $100,000.
>
> (b) DEFINITIONS.—As used in this title—
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> (1) The term 'personal holding company' means any corporation (other than a corporation exempt from taxation under section 101, and other than a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, and other than a life insurance company or surety company) if (A) at least 80 per centum of its gross income for the taxable year is derived from royalties, dividends, interest, annuities and (except in the case of regular dealers in stock or securities) gains from

> the sale of stock or securities, and (B) at any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals * * *."

The Regulations involved promulgated pursuant to the above statute are Treasury Regulations No. 86 promulgated under the Revenue Act of 1934. The applicable part thereof defining "royalties" reads as follows:

> "Art 351-2, (1) * * *. (2) Royalties.—The term 'royalties' includes amounts received for the use of or for the privilege of using patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property. It does not include rents, nor overriding royalties received by an operating company. As used in this paragraph, the term 'overriding royalties' means amounts received from a sublessee by the operating company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid."

The applicable parts of the Revenue Act of 1936 (Sec. 351, C. 690, 49 Stat. 1648), and of the Regulations promulgated thereunder are not set forth because they are identical with the foregoing for our purposes.

## DATE OF JUDGMENT.

(C) The date of the judgment sought to be reviewed is November 11, 1941 (R. 94). Petition for rehearing was denied December 16, 1941 (R. 114).

## III.

### Concise Statement of Case.

In the interest of brevity, we refer to the Summary Statement of Matter involved, contained in the Petition herein, which is sufficient for our purposes in lieu of restating the same at this point.

## IV.

**The Taxpayer Desires to Urge the Following Errors:**

1. The majority opinion of the Circuit Court erred in not holding that the taxpayer's income was from rents.

2. The majority opinion of the Circuit Court erred in holding that "rents" may be included in computing personal holding company income under the words "other like property" in the regulations.

3. The majority opinion of the Circuit Court is in conflict with two decisions of this Honorable Court, namely, Duffy v. Central Railroad Company, supra, and M. E. Blatt Company v. U. S., supra.

4. The majority opinion of the Circuit Court erred in holding that the taxpayer had a property right in a system of doing business, and to this extent is in conflict with the opinion of the United States Circuit Court of Appeals for the First Circuit, in Affiliated Enterprises, Inc. v. Gruber, 85 Fed. (2nd) 958.

## V.

## ARGUMENT.

**First, Second and Third Assignments.**

"Rents," after considerable discussion in Congress, were excluded from personal holding income in the 1934 and 1936 Acts, in order that operating companies might not be included unfairly under the personal holding company statute, which was aimed at penalizing incorporated pocketbooks. For this reason, rents specifically were stated to be excepted from personal holding company income in the above Regulations.

Practically all the taxpayer's income in each of the taxable years in question was from stated payments required to be made without reference to any other factor (R. 25), and constituted rents under the decisions of this Court and cannot be termed royalties under the words "other like property" in the Regulations, which also expressly except rent from personal holding company income.

We have quoted from the Duffy case, supra. On April 27, 1936, pursuant to a request for a ruling as to the distinction

between the terms "rentals" and "royalties" as used in an oil and gas lease owned by a corporation, in order to determine whether it was a personal holding company, IT 2970 was issued, which reads in part as follows:

> "The term 'rental' must be taken in its usual and ordinary sense, that is, as applying to a fixed sum to be paid at stated dates for the use of property. (Duffy v. Central Railroad Co. of New Jersey, 268 U. S. 55; Frank & Seder Co. v. Commissioner, 33 B. T. A. 476). It was said 'the word "royalty" as used in a gas lease generally refers to "a share of the product or profit reserved by the owner for permitting another to use the property."'
>
> "While it is apparent that the fixed annual payments of x dollars provided for in Article IV of the lease here in question are rents, * * *."

The Blatt case, supra, was decided by this Honorable Court on December 5, 1938, in which the Duffy case, supra, was cited with approval, with other cases from Rhode Island, Massachusetts, New York, Louisiana, and 2 Blackstone, page 41.

Thereafter, IT 3401 was issued in 1940, concerning the distinction between the terms "rentals" and "royalties" under an oil and gas lease in order to determine whether a taxpayer was a personal holding company. This decision and two General Counsel Memoranda referred to therein follow the Duffy and Blatt opinions. We quote from IT 3401, Prentice Hall, 1940, Sec. 66318, briefly as follows:

> "I. T. 3401—Personal holding company income—'receipts under oil and gas leases' held to be 'rents' * * *.
>
> "Advice is requested whether the M corporation complies with the gross income requirements for classifications as a personal holding company under the provisions of the Internal Revenue Code.
>
> "The underlying question is whether an item of income designated 'receipts under oil and gas leases' in the amount of x dollars, such item amounting to less than 50 per cent of the corporation's gross income, constitutes 'rents' within the purview of Section 502

(g) of the Internal Revenue Code. The reference to this item, which is contained in a lease reads, 'The lessee shall pay to the lessor as a rental therefor, the sum of one dollar ($1) per acre per year, commencing on date of execution hereof and payable semi-annually in advance.

* * * * * * * * *

"While the question of whether 'delay rentals' constitutes 'rents' as that term is used in Section 502 (g) of the Internal Revenue Code does not appear to have received the consideration of the courts, the Bureau has held that for Federal income tax purposes 'there is no distinction between the term "rent" in the sense in which that term ordinarily is used, and "delay rentals." ' (G. C. M. 11197, C. B. XII-1, 238 (1933).) In the consideration of this question, it is further stated in C. G. M. 11197, that:

"'* * * 'Rent is a fixed compensation paid for the use, possession, or interest in land or other property.

"'* * * 'Care must be taken to distinguish between rent and royalty in connection with gas and oil leases. Rent is the term applied to the privilege given to bore for gas and oil and for delay in beginning operations; while royalty is a certain percentage of the oil after it is found, or so much per gas well developed.'

"It is, accordingly, held that the item 'receipts under oil and gas leases' in the sum of x dollars constitutes 'rents' within the purview of Section 502 (g) of the Internal Revenue Code."

In Burnet v. Hutchinson Coal Co., 64 Fed. (2nd) 275, 12 A. F. T. R. 391, the Court held that the amount required to be paid on a coal lease, regardless of mining operations, although minimum royalties could be charged against said stated amount, was rental and not royalty, because it was required to be paid, even though the property might not be used. This case has been cited with approval in many later cases, among which are Commissioner v. Wilson, 76 Fed. (2nd) 766, 15 A. F. T. R. 1228.

We omit other cases to the same effect.

That all dictionaries, including Bouvier's Law Dictionary and Webster's International Dictionary, cited by the Circuit Court, are in accord with the foregoing definite distinction between rentals and royalties, is established by the following quotations therefrom:

> "Royalty. A payment reserved by the grantor of a patent, mining lease, etc., and payable proportionately to the use made of such right." Bouvier's Law Dictionary, 1928, p. 1078.
>
> "Rent. Some of the common law properties are that it must be a profit to the proprietor, CERTAIN in its character, or capable of being reduced to a certainty, issuing yearly, that is periodically, out of the thing granted, and NOT BE PART OF THE LAND or thing itself." Bouvier's Law Dictionary, 1928, p. 1047.
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> "Rent is a CERTAIN and PERIODICAL payment or service made or rendered by the tenant of a corporeal hereditament and issuing out of (the property of) such hereditament." Encyclopedia Britannica, 11th Ed. Vol. XXIII, p. 102.
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> "Rent. In law (a). A compensation or return made periodically, or fixed with reference to a period of time, for the possession and use of property of any kind." Century Dictionary & Encyclopedia, Vol. VI, p. 5078.

In view of the foregoing and the Duffy and Blatt decisions of this Court, the following conclusions necessarily follow:

If the respondent had contracted to lease a producing oil well at the rate of $5 per week, as here, its income would have been rentals under every decision of the Supreme Court of the United States, and the rulings of the Income Tax Unit, because fixed sums required to be paid at stated times are rentals.

If the respondent had contracted to lease a producing metal mine at the rate of $5 per week, as here, its income would have been rentals under all the authorities referred to above, because fixed sums required to be paid at stated times are rentals.

If the respondent had contracted to lease a valuable trade-mark at the rate of $5 per week, its income would have been rentals under all the authorities, because fixed sums required to be paid at stated times are rentals.

If the respondent had contracted to lease the right to publish a copyrighted book or other article, at the rate of $5 per week, as here, its income would have been rentals under all the above authorities, because fixed sums required to be paid at stated times are rentals.

If the respondent could have acquired the absolute ownership of the system by patent, copyright or trade-mark, its income still would have been from rentals because, under all the authorities, A FIXED SUM REQUIRED TO BE PAID AT STATED TIMES, WITHOUT REGARD TO USE, IS RENTAL.

In view of the fact, therefore, that practically all the income of the taxpayer was from fixed sums paid at stated times, the question of whether the taxpayer had any patents, copyrights or trade-marks is entirely immaterial in this case, unless all the established definitions of "rents" are to be ignored.

In spite of the Duffy and Blatt decisions, supra, and the intention of Congress that "rents" should not be included in personal holding income, and the other authorities which we have cited, and in spite of the fact that the Circuit Court recognized that the taxpayer's income was not royalty in its ordinary sense, nevertheless, the Circuit Court concluded that the taxpayer's income was subject to the personal holding company statute under the words "other like property" in the Regulations.

We respectfully submit that "rentals," which were intentionally excluded by Congress from the personal holding company statute, may not be reinstated therein by judicial construction under the words "other like property" contained in the Regulations, and yet this is the effect of the opinion of the lower Court.

The anomalous situation which has arisen here is further accentuated by the fact that the lower Court's majority opinion holds that, because the statute was reenacted, rents,

twice excluded by Congress, shall now be included under the words "other like property."

If this construction is to stand, flat rentals paid under oil leases and mining leases must be held to be royalties, contrary to decisions of this Court cited above and consistent departmental decisions based thereon.

Only confusion and an entire revision of these departmental rulings can result unless the Circuit Court opinion is reversed.

This is particularly true in view of the fact that all Revenue Acts and Regulations adopted pursuant thereto subsequent to the Acts involved here, have contained personal holding company terms similar to those involved here, the limits of which should be defined by this Honorable Court.

The situation is similar to that involved in Maass, Ex. v. Collector, decided by this Honorable Court on March 3, 1941, in which certiorari was granted, although there was no conflict between decisions of the Circuit Court of Appeals, "because of the importance of the question." There a regulation was abrogated because it was considered an unwarranted extension of the plain meaning of the statute.

Here, an ambiguous regulation has resulted in a Circuit Court opinion whereby rents have been reinstated in the personal holding company statute as applied to an active operating company contrary to the plain intention of Congress that operating companies should not be affected by the personal holding company statute unless clearly within the terms thereof. An ambiguous regulation is not binding upon the Courts, Sanford Estate, 308 U. S. 89, 34 L. Ed. 20, but in view of the Circuit Court opinion, it is apparent that this regulation now should be construed.

We respectfully submit that the writ should issue and this Honorable Court should define the meaning of the word "royalties" in the personal holding company statute and the meaning of the word "rents" and the words "other like property" in the Regulations.

**Fourth Assignment.**

The Circuit Court held that the taxpayer had a property right in its idea or system if it was new or novel (R. 97) and

cited, of its own motion, five cases, none of which sustained that position, and all of which hold that the idea not only must be new or novel, but must be *unknown,* and that after the first disclosure, the originator has no property right therein (R. 97).

This holding is in direct conflict with Affiliated Enterprises, Inc. v. Gruber, 86 Fed. (2nd) 958, in which the Court said:

> "As the system has not been copyrighted and being in no sense a writing, could not be (Constitution, Art. 1, Section 8 cl. 8; 17 U. S. C., Section 4; 17 U. S. C. A. Section 4) and has not been patented, if it could be, we are constrained to hold that, although plaintiff has expended time and money in originating and developing a system, IT HAS NO PROPERTY RIGHT THEREIN which has been appropriated by the defendants. While the plaintiff restricts operation under the system to its licensees, by its very nature, in order for it to operate, knowledge thereof must be thrown open to the public and any property right based upon secrecy was lost as early, at least, as the first public exhibition, and there was no surreptitious appropriation of knowledge of the system by the defendants. In this respect it differs from the case of Board of Trade v. Christie Grain & Stock Co., 198 U. S. 236, 25 S. Ct. 637, 49 L. Ed. 1031, and other like cases. The situation is analogous to that where an inventor of an unpatented machine licenses others to use it in a way disclosing the device to the public, in which case there is nothing to prevent the public from building and using it."

Said holding, also, not only is contrary to the weight of authority, but we have been able to find no authority to sustain it.

Respectfully submitted,

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